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Mario Saric, Scotiabank

Andrew Kuske, Credit Suisse

PRESENTATION

Operator

Welcome to the Brookfield Asset Management Second Quarter of 2018 Conference Call and Webcast. As a reminder, all participants are in a listen-only mode and the conference is being recorded. After the presentation, there will be an opportunity to ask questions. To join the question queue, you may press star then the number one on your telephone keypad. Should you need assistance during the conference call, you may signal an operator by pressing star and zero.

I would like to turn the conference over to Suzanne Fleming, Managing Partner, Branding and Communications. Please go ahead, Ms. Fleming.

Suzanne Fleming, Managing Partner, Branding & Communications

Thank you, operator, and good morning, everyone. On the call today are Bruce Flatt, our Chief Executive Officer; Brian Lawson, our Chief Financial Officer; and Ben Vaughan from our infrastructure business. Brian will start off by discussing the highlights of our financial and operating results for the quarter and Bruce will then give a business update and finally, Ben will give a brief infrastructure update. After our formal comments, we'll turn the call over to the operator and take your questions. In order to accommodate all those who want to ask questions, we ask that you refrain from asking multiple questions at one time in order to provide an opportunity for others in the queue. We will be happy to respond to additional questions later in the call, as time permits.

I'd like to remind you that in responding to questions and in talking about new initiatives and our financial and operating performance we may make forward-looking statements, including forward-looking statements within the meaning of applicable Canadian and U.S. securities law. These statements reflect predictions of future events and trends and do not relate to historic events. They are subject to known and unknown risks and future events may differ materially from such statements. For further information on these risks and their potential impact on our company, please see our filings with the securities regulators in Canada and the U.S. and the information available on our website.

Thank you. And now I'll turn the call over to Brian.

Brian Lawson, Chief Financial Officer

Thanks, Suzanne, and good morning to all of you on the call.

So, let me start out by saying that we are pleased with the results for the quarter. In particular, they highlight the continued growth in both our asset management business and the businesses underpinning our invested capital.

Looking at the quarter, net income was \$1.7 billion, or \$0.62 per share attributable to Brookfield shareholders, and that's almost double that of last year. Funds from operations, or FFO, totaled \$790 million, or \$0.77 per share. Excluding disposition gains, FFO was up 17% over last year. Both FFO and net income benefited from an increase in fee-related earnings as well as contributions from new investments. Net income also reflects transaction and valuation gains within our opportunistic real estate portfolios.

Within the asset management business, fee-related earnings were \$239 million for the current quarter, up from prior year, and that's due primarily to growth in fee-bearing capital as well as higher performance fee income. The fee-bearing capital is now just shy of \$130 billion and the growth came from both new private fund capital, both the flagship funds, as well as newer product offerings.

Moving over to carried interest, unrealized carry now stands at \$2.5 billion before costs and that includes \$114 million generated during the quarter. The increase came across the real estate, infrastructure, and private equity businesses. We expect half of that unrealized carry balance to be realized in FFO over the next few years as the corresponding funds move through the performance hurdles, clawback thresholds, and continue to monetize assets.

Turning to invested capital, excluding disposition gains, FFO from invested capital increased by 26% over the quarter. That reflects the benefit of organic growth, same property leasing growth, additional home closings in our North American residential business, and improved performance by companies within the private equity operations. We also benefited from contributions from recent acquisitions which exceeded the FFO that was foregone from the assets that we've sold over the past 12 months. The disposition gains in FFO contributed \$132 million in the quarter, mainly from the sale of a partial interest in our graphite electrode manufacturing business and the sale of a joint venture interest within our real estate brokerage services.

Core liquidity is at an all-time high of \$33 billion, and of this \$33 billion, \$22 billion is from unfunded commitments and \$11 billion is core balance sheet liquidity. We continue to increase the level of our free cash flow, which now stands at approximately \$2 billion on an annual basis. This consists primarily of the fee-related earnings, along with the distributions we received from our invested capital, and it's increasingly supplemented by carried interest. We can use this capital in many ways, including stock buybacks, supporting transaction execution by our funds, and by seeding new products on our balance sheet, such as our credit portfolios.

Finally, I'm pleased to confirm that our Board of Directors has declared a \$0.15 quarterly dividend and that will be payable at the end of September and this is a 7% increase over the prior year.

And with that, I will hand the call over to Bruce.

Bruce Flatt, Chief Executive Officer

Good morning. As Brian noted, in the last few months we have completed or advanced a number of large transactions. This included the acquisition of the balance of GGP for \$15 billion. There were a number of other transactions which I won't repeat here, but in our shareholder letter we provided comments on some of these. We completed the acquisition of a large midstream natural gas gathering system in western Canada for \$3.3 billion, closed the acquisition of Westinghouse Electric Company for a total purchase price of \$4 billion, committed to

acquire Forest City Realty and Enercare for \$7 billion of equity and \$2.5 billion of equity respectively, and acquired a number of solar and wind facilities in Spain for approximately \$1.2 billion. While all of these together represent a significant number of transactions, many have been in the works for a long time and, despite all of our activity, we currently have record levels of liquidity across our entire business.

Turning to the markets, most of the economies where we participate continue to be favorable or are strengthening. This contributes to strong performance across the business, as Brian mentioned. Institutional investors continue to allocate increasing portions of their funds to real assets and therefore we see strong growth in assets under management as a result of this. Fundraising activity across the board continues to be strong. We also continue to harvest capital, enabling us to recycle proceeds from assets where we have completed our value-creation initiatives, and notwithstanding strong valuations in certain segments, our scale, geographic reach, and operational focus ensures that we are able to continue to source and execute acquisitions, allowing us to rotate capital in the business. Bank liquidity is still strong and capital markets are freely open and available with credit spreads having stabilized following slight volatility earlier in the year.

We often get asked about interest rates and how that affects our business and we believe we are still in a period of historically low global interest rates, despite the narrative of “rising interest rates and increasing inflation.” Owning real assets means that we are primarily focused on longer-term rates, to be very specific, which have remained low and, in particular, low outside the United States. Specifically, Japanese bonds are still at essentially zero all the way to 30 years. German rates are extremely low, negative 60 basis points on the short end and 40 basis points at 10 years. In addition, many other countries continue to have very low rates and these are expected to persist for the foreseeable future. Not only does this mean that our borrowing costs in those regions are low, but in today’s global capital markets, with investors seeking yield, that also keeps U.S. rates lower. Specifically on the United States, growth continues to be strong and interest rates have been increasing faster than any other country, yet the 10-year bond continues to trade below 3%. We believe the outlook continues to reflect steady modest rises and we expect the 10-year bond to level out in the range of 3.5% by the end of 2019. The slope of the yield curve continues to flatten, as most of you would know, with the spread between two-year and 10-year treasuries at only 30 basis points today. This, in our mind, implies very limited expectations of interest rate increases. With 50% of our assets in the U.S., this positions us well to benefit in this environment.

With those comments, I will now turn it over to Ben Vaughan, who is Senior Managing Partner of our Infrastructure Business, and he will provide an update on some infrastructure business recent transactions, organic growth, and their investment pace and pipeline.

Ben Vaughan, Senior Managing Partner, Infrastructure Business

Thank you, Bruce, and good morning, everyone. I’ll take this opportunity to discuss the current investment climate in the infrastructure sector, provide an update on some transactions we recently announced that we’re pretty excited about, and talk about our plans for the balance of the year.

Starting with the investment climate, over the past several months we’ve been very active and have secured three investments totaling almost \$5 billion of equity in the energy and data infrastructure sectors. And I’ll make a few comments about these two sectors and describe the investments we’ve secured, starting with data infrastructure.

I think we’ve discussed in the past how we see the exponential growth in data usage worldwide as a significant opportunity for our business. In particular, large-scale infrastructure investments will be required to transport and store a growing and massive amount of data. And over the past few years we’ve made several investments in data infrastructure, including in our U.K. regulated distribution business, which deploys fiber-to-the-home networks, and our French communication infrastructure business, which is the leading independent broadcast and telecom tower operator in France. And we continue to grow in the space, and recently announced the acquisition of AT&T’s U.S. datacenter business for \$1.1 billion or \$560 million of equity. This business is a high-quality, multi-tenant service provider supplying colocation services to top-tier customers through 31 well-located datacenters across the U.S. The customer base is very large, well diversified and comprised of over 1,100 companies across multiple industries. And we expect solid organic growth in the business as we improve the utilization of existing capacity and anticipate being

able to add new sites over time through both development and roll-up acquisition strategies. This business will serve as a platform to benefit from the long-term growth trends in the data infrastructure market.

Turning to the North American energy sector, we initiated a strategy well over a year ago targeting mostly midstream assets after we saw a selloff in listed energy infrastructure companies, while at the same time the U.S. is transitioning to being a net exporter of energy. So there's a big need for capital to invest to extract, transport, and process the resources. Our opportunity set here includes potential asset carve-outs, take-privates, and partnership arrangements. The recent market environment presented us with an attractive set of opportunities from parties who value our solid balance sheet, proven operational track record, and ability to act as a single counterparty for large deals. And as a result, we recently announced a definitive agreement to acquire 100% of Enbridge's western Canadian natural gas gathering and processing business for \$3.3 billion, representing a total equity investment of \$1.8 billion. And this is, I think as Bruce touched on earlier, this is the largest independent operation of its kind in Canada. It's strategically positioned in the prolific Montney region of British Columbia and Alberta. The business has 19 natural gas-processing facilities and over 3,500 kilometers of gathering pipelines and it's very well connected to major demand markets, including the U.S. Pacific Northwest, the U.S. Midwest, and Alberta, giving producers multiple market access options. We see this business as an ideal platform to establish our midstream presence in Canada and expect to close this transaction in two stages. The first, there'll be a first close in Q4 of this year and a second in the first half of 2019.

So, both the AT&T and Enbridge opportunities resulted from our ability to execute on carve-out transactions from large industrial companies that consider the assets over time as non-core. And as a result, in each case we believe we have an entry point at good value and can leverage these platforms for future growth.

And then finally, just last week we announced the acquisition of 100% of the shares of Enercare Inc., which is a leading provider of essential residential energy infrastructure in both Canada and the U.S., predominantly water heaters and air conditioning units. The total enterprise value of the company is \$3.3 billion with an equity commitment from us of \$2.3 billion. This is a very high-quality, annuity-like business with a well established market position. The business has been around for over 50 years and currently has approximately 1.2 million rental units in the market. Revenues are underpinned by long-term, inflation-linked contracts and so the business generates very predictable and stable long-term cash flows. And we're particularly excited about this business as we believe there are a number of Brookfield-managed businesses that we can leverage to further enhance growth, specifically some utilities we oversee in the U.S., our condo servicing and multifamily businesses, and our homebuilding businesses. And this transaction is expected to close in the fourth quarter of this year.

Turning to our future plans, with all these capital deployment we've now committed about 75% of the capital from our current infrastructure fund, which was a \$14 billion fund that we raised in 2016, so we're now positioned to begin fundraising for the next flagship Infrastructure fund and we expect to start this in the fourth quarter of this year. As Bruce mentioned, with interest rates continuing to be on the low end, infrastructure remains a core and growing real asset allocation across our investor base, so we're excited to get this going.

And with that, I'll pass the call back to Bruce.

Bruce Platt, Chief Executive Officer

So, operator, if there are any questions from anyone, we would be pleased to take them.

QUESTION AND ANSWER SESSION

Operator

At this time I would like to remind everyone in order to ask a question press star then the number one on your telephone keypad. We'll pause for just a moment to compile the Q&A roster.

Your first question comes from the line of Ann Dai with KBW. Your line is open.

Ann Dai, KBW

Hi. Thanks and good morning. Bruce, I was hoping to address something that was touched upon in the shareholder letter, which was this increased focus on share buyback and the goal of shrinking share count back to 1999 levels. I guess first thing is just kind of clarification on the timeframe. So should we be thinking about midterm as a handful of years or is this really a longer term, medium term than that?

And then just curious as to what behind the scenes led to maybe a more constructive view on capital return. I think in the past your commentary has been more about highlighting the value you see in BAM shares but then highlighting the need to also keep liquidity on hand should opportunities arise rather than committing to the buybacks. So I guess I'm just wondering what drove maybe a greater bias towards a more active capital management strategy.

Brian Lawson, Chief Financial Officer

Sure. Hi, Ann. It's Brian. So I'll kick it off with respect to the term and things like that and maybe bridge a little bit into the second part of your question as well.

So, in terms of thinking about timeframe, I think you positioned it well; it's kind of medium term to longer term. And this has always been something that's been an important part of our capital strategy and so we felt it was worth reiterating that. And this is, I guess, in part getting at the second half of your question, one of the things that you would have observed over the past couple of years is the amount of free cash flow within the business has grown significantly with the growth in the fee-related earnings and the distributions from the invested capital and it does beg the obvious question, what are we going to do with that capital?

As in prior years, it's always been a mix of thinking about where the optimal return is to grow the business as well as enhance shareholder returns and so we've grown the dividend at a relatively modest but we think is an appropriate rate given the nature of the business, but then a focus on buying back the stock as opposed to redeploying the capital and compounding it within the business. And, as you would have observed, we've been more focused on that over the past number of years. We still did buy back to around \$250 million of stock over the last years, so we haven't been totally absent from that.

So with the growth in the distributable cash flow, that gives us a lot more latitude to be thinking about that in addition to the other important things that we do with the capital and all of that will be balanced out with our view as to what is the appropriate liquidity balances across the firm as well as balance it against the other opportunities to create shareholder value.

Ann Dai, KBW

Okay. I appreciate the color. Just one quick one on GGP. Also in the shareholder letter you guys discussed the potential for development of land associated with that acquisition for uses outside of retail. So should we be expecting to see that as incremental to the pace of development that we're already seeing within BPY and over what timeframe should we be expecting to see that take place?

Bruce Flatt, Chief Executive Officer

So maybe I'll take a shot at it and I would say we're still in the early phases of developing the plans for the company and the real estate team is, the BPY team. But these, I guess the point we were trying to make with the comments in the letter is what we're acquiring are 23-acre parcels in most major cities in the United States. And what these are

can be as highly concentrated into redevelopment with all the other things that we do. And you could do a small amount of that within GGP but in a private context underneath the umbrella of a more diverse and broad BPY – and with the funding sources and with the operating that people we have, we should be able to develop at a much, much faster pace. Whether we do that with BPY capital or do we raise outside funds to do it, we'll have to fit that into the context of the BPY capital plan, but there are very significant amounts of redevelopment into alternative uses outside of the retail plan that the GGP people have always operated with.

Ann Dai, KBW

Okay. Point taken. Thanks, Bruce.

Operator

Your next question comes from Cherilyn Radbourne with TD Securities. Your line is open.

Cherilyn Radbourne, TD Securities

Thanks very much and good morning. I also wanted to pick up on this discussion of free cash flow and share repurchases and the question I wanted to ask was just how much of that \$2 billion you think you need to retain at this point to seed new fund strategies and support larger transactions and does that amount you need to retain scale in proportion to the growth in the business or do you reach a point at which it starts to diminish because the asset management franchise has matured and then has the full complement of investment strategies on offer?

Bruce Flatt, Chief Executive Officer

It's Bruce. I'll maybe just take that to start off with, and then Brian can add to it. But I'd just say that the first comment is, and we're always unsure of what to say to the shareholders when we write things like that, especially related to how we're going to deploy cash, because we actually, to be brutally frank about it, we never know what's coming around the corner, and that's because the capital markets change and also opportunities change. So I would say if we were status quo the way we are running the business, we now have the company into a form where most of the free cash flow, if we chose to, could be returned to the shareholders when we don't really need it within the business.

The only caveat to that is we don't know what the market price is of the securities we'll be repurchasing, and we'd like to repurchase them and add value to everyone's shares that are retained afterwards. And secondly, we don't know what comes available in the market to add more value than what repurchasing shares would add. And so I would say in the absence of either of those two, then we'll return very significant amounts of cash over the next 15 years as we go forward, but the caveat being you never know what comes along that might be better.

Cherilyn Radbourne, TD Securities

Okay. And my second question, separately, you've included some expanded disclosure on slides nine and ten in the supplemental, so I was hoping you could just hit on what you think are some of the more important takeaways and where we should zero in to assess how you're tracking towards the \$8 billion of cumulative growth carry that we talked about at your last Investor Day.

Brian Lawson, Chief Financial Officer

Sure. Thanks, Cherilyn. It's Brian. So I'll kick it off with that one.

So I'd say there's two points we are trying to provide some more color, clarification, context around, and one was, I'll say, the pace at which you should expect to see carry manifest itself in the business in the form of unrealized carry, meaning that carry that's actually generated within the funds, but hasn't necessarily been paid out and passed the clawback period and therefore being booked as FFO. And so that's really the part on slide nine. And just for those of you that would not have that handy on the call, what we did there was we took the total amount of carry-eligible capital and we bifurcated it into two pieces. One is the piece that is currently invested and therefore is actually clocking in investment return and hence driving carry currently. And then the other piece is dry powder or uncalled fund commitments that when they do get invested will, of course, start generating, a potential to generate carry as well.

So you can really think about it the one piece you should see driving unrealized carry that we would report to you on a quarterly basis and then as we deploy that uncalled fund commitment, so that's another, that's really getting at that \$22 billion of dry powder; it's \$21 billion specifically in terms of carry eligible. That will drive additional unrealized carry. And the two of them together really come up with what we have historically called as the net target carried interest of about \$800 million a year. So that's really what we're trying to achieve with the first one.

The second one was to really report back to you and say we've always told you this is how much carry we would expect to be generating the business, presuming that we hit our target returns. So this is coming back to you and basically giving you a bit of an update, a bit of a scorecard on how we are tracking against those target returns by giving you some updated IRR information on the funds. So those are really the two points we we're trying to give you a bit more color on.

Cherilyn Radbourne, TD Securities

Great. Thank you. That's my two.

Operator

Your next question comes from the line of Mario Saric with Scotiabank. Your line is open.

Mario Saric, Scotiabank

Maybe just quickly returning to the core liquidity discussion which, as you noted in the letter to shareholders, is at an all-time high. There could be, I guess, a couple of drivers behind that. One, just the structure of the company today and the amount of free cash flow growth that you've highlighted, \$2 billion or so per year just to necessitate the buildup of cash and liquidity. The second could be in part your view of where you are in the cycle and potential opportunities that may present themselves going forward. I'm just kind of curious, in the last call in three to six months, which factor has perhaps played a bigger role in terms of really driving that liquidity higher?

Brian Lawson, Chief Financial Officer

Hi, Mario. It's Brian. So I'll start off with that one. So I think it really hits both the points you're saying, you mentioned there. One is just the continued expansion of the listed issuers and Brookfield itself, which has resulted in more core liquidity at each of the entities. And that's not just the distributable cash flow coming in but it's also just representative of the scale of the business continuing to expand and the increased capitalization of those listed issuers that supports that liquidity. So that's one piece of it. So I'd say part of it is the natural evolution of the growth of the business.

As it comes back to the second point, which is should you be looking into that in terms of our views on the market, I think Bruce touched on that earlier – you just don't necessarily know what's going to come around the corner. So we

are mindful of the potential for liquidity events more broadly in the market, which we want to make sure that we can, first of all, ensure that we are extremely well defended against but, as importantly, that we're in a position to move quickly and seize on some of those opportunities as they may arise.

So it's a bit of both but I think the business has grown and the transaction volume, so we think it's inappropriate to carry its increased level of liquidity.

Mario Saric, Scotiabank

Okay. And then maybe as a follow-up to that, to my recollection this may be the first time that you highlighted a target shares outstanding, which is roughly 100 million lower than where you are today. What was the process in identifying kind of that target at this stage?

Brian Lawson, Chief Financial Officer

I'd say it's more of an indication. And where we started with that is, as you may have noted, that we actually had a chart in the letter that referenced the fact that we've been able to expand the business significantly and the cash flows while keeping the share count as the same. And what you would have noticed over the years, we have often been able to or often as a result of our buybacks being able to actually reduce the share count and return that benefit to the stockholders. So it's a bit of both. One is that the placeholder of the share count, the fact that it has remained so constant, but also, I guess, a bit of a reminder that historically we have been able to do that over time and the importance of our share buybacks in our overall capital allocation thinking.

Mario Saric, Scotiabank

Got it. Okay. And then my second question just relates to Global Infrastructure Fund IV. As you embark on fundraising for the fund later this year, when we think about fund size, both client demand and ability to deploy capital play a key factor in identifying kind of optimal size. As we sit here today, how would you compare your sentiment on both fronts, kind of both demand as well as ability to deploy, relative to how you felt in 2015 when you were heading into kind of the fundraising cycle for GIF III?

Bruce Flatt, Chief Executive Officer

Yeah, it's Bruce. I would say there is very significant amounts of capital available today on the supply side of institutional investors for infrastructure. So that does probably mean that we can have a larger fund than we have today.

On the investment side, compared to three years ago, I would say that for very run-of-the-mill, easy-to-accomplish acquisition of transaction, there's a lot of money out there and it's very difficult to buy transactions. For the things that we do, which rely on our three competitive advantages, which are, as most of you will know, scale, our global business, and our operating capabilities, there's still lots of transactions and we see no lack of availability of transactions just given that. And I don't think it's really that much more difficult than it was three years ago and probably our name is known better in the business globally and therefore it may even be easier in some places.

Mario Saric, Scotiabank

Okay. Thank you.

Operator

Again, if you would like to ask a question, press star, then the number one on your telephone keypad. Your next comes from Andrew Kuske with Credit Suisse. Your line is open.

Andrew Kuske, Credit Suisse

Thank you. Good morning. I think, Bruce, you touched upon the essence of my question in relation to BPY surfacing value out of GGP in the future, but I guess just simply, as you see the portfolio of assets that you hold, either via the LPs or in fund constructs, do you see Brookfield as having a greater opportunity for ongoing organic and greenfield development from those assets?

Bruce Flatt, Chief Executive Officer

I hope this answers the question or I'll try. The portfolio of assets we have is among, in real estate, is among the best in the world, and what's happening in urban centers and in large places where people live is that the cities are urbanizing more every single day. And what that means is that the prices that land values in cities is getting greater and greater. And that's due to younger people wanting to live in cities, older people wanting to live in cities and have all the benefits that come along with it, the concentration and them going high-rise and changes in density and cities changing and the ability to not, the desire not to want to sprawl across everywhere outside a city. And with that, the pieces of land and the density rights that are within the real estate portfolios that we have globally get more valuable and more valuable every single year, and with that means that there's lots of redevelopment potential and development potential in the portfolio. So I think over the next 25 years the inherent values of the assets that we hold and many large urban portfolios will continue to go up.

Andrew Kuske, Credit Suisse

Okay. That's helpful. And then maybe given that Ben's on the call and sort of tied to embedded organic value and greenfield potential, with the Enbridge portfolio that you're in the process of purchasing, did your underwriting economics get affected by any potential of looking at things like Niska, which you bought in the past, NGPL, and just the interrelationships of the businesses?

Ben Vaughan, Senior Managing Partner, Infrastructure Business

Andrew, underwriting of Enbridge was for that specific asset. There really wasn't any direct synergies or benefits from the other energy infrastructure assets. What underpinned the underwriting of Enbridge was just the ongoing growth in the Montney region and the underlying business itself. There really wasn't a broad interaction with other assets we own.

Andrew Kuske, Credit Suisse

Okay. That's helpful. Thank you.

Operator

This concludes the question-and-answer session. I will now hand the call back over to Suzanne Fleming for closing comments.

Suzanne Fleming, Managing Partner, Branding & Communications

Thanks, operator. Just as a reminder for those on the call, we'll be hosting our annual Investor Day on September 26th in New York, so we hope to see you there. And with that, I will end the call. Thanks for joining.

Operator

This concludes today's conference call. You may now disconnect.
